

D-7

STATE OF HAWAII
Department of Land and Natural Resources
Land Division
Honolulu, Hawaii 96813

February 23, 2001

Board of Land & Natural Resources
State of Hawaii
Honolulu, Hawaii

OAHU

Subject: Methodology for Determining Lease Rent for the Kaneohe Bay Recreational Piers at Kaneohe Bay, Oahu

Background:

In May 1998 the Board of Land and Natural Resources approved a plan to address the problem of unauthorized piers in Kaneohe Bay and created a program to bring the piers into compliance with the law.

During the 2000 legislative session, the Legislature passed Act 261, which allows the Board to issue direct leases for private non-commercial residential piers. Prior approval by the Governor and Legislative is no longer required for dispositions processed under Act 261. However, the bill will sunset on June 30, 2005.

The staff has completed an inventory of some of the Kaneohe Bay piers. An Environmental Assessment {EA} and Conservation District Use Application {CDUA} are being prepared for the Kaneohe Bay Piers and will be submitted for formal processing shortly. The staff has had several meetings with the pier owners group to discuss the process. We have found there are several categories of piers in Kaneohe Bay based on the type of permits obtained.

One of the major areas of concern has been the proposed lease rent for the pier structures. Some of the pier owners have expressed concern over the methodology used to calculate the pier rents. In order to move forward, we discussed with the pier owners the need to clarify the lease rent calculation methodology as soon as possible. This would give the pier owners some guidance in determining their lease rent so that they may plan accordingly.

This matter was presented to the Board in the fall of 2000. The Board deferred action and asked staff to look at alternative methodologies. Specifically, the Board was interested in establishing a flat fee for these types of piers in Kaneohe Bay. The submittal before the Board today will present various alternative methodologies for calculating the pier lease rents. Also, staff is proposing that the Board adopt our recommended and preferred methodology for calculating the pier lease rents.

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Alternative Methodologies:

Staff identified the following methods:

Method 1: The per sq. ft. value of the abutting residential fast land is estimated under the assumption there is no pier. The per sq. ft. value of the submerged land is calculated as a percentage [usually 50%] of the per sq. ft. value of the abutting residential fast land. A residential rate of return [usually 4%] is applied to the value of the submerged land to determine the annual rent. A present value factor is applied to the rent or an appropriate percentage is applied to the value of the submerged land to determine the lump sum payment.

Submerged Land Percentage: The value of submerged land has historically been considered to be 50 percent of the value of the abutting fast land.

Rate of Return: The law restricts the rate of return on residential property serving a residential use to no more than 4 percent. The subject fast land would command a 4 percent return. It would be inconsistent to use a different rate for the submerged land which is seen as an integral part of the residential site.

Lump Sum Payment: It is recommended the lessee pay a one time lump sum payment in return for a 55 year submerged land lease. A 4 percent discount rate over 55 years is reasonable.

Example:

Tax assessed land value:	\$20.00
	<u>50%</u>
Submerged land value:	\$10.00
Pier Area:	<u>400 square feet</u>
Pier Submerged Land value:	\$4,000

$\$4,000 \text{ submerged land value} \times 0.04 \text{ rate of return} = \160 annual rent
 $\$160 \text{ annual rent} \times 22.1086 \text{ PV factor} = \$3,537 \text{ PV rents}$

Fast Land Value: The value of the fast land can be determined either by deriving benchmark land values from the market or by using the city & county's assessed values. Initially, it appeared Kaneohe Bay consists of three distinct neighborhoods and as such, would require three land value benchmarks; however, we consulted with the county assessor's office and found they relied on 14 benchmarks. The assessor's office stated this was necessary due to the diversity of the bay and its oceanfront properties. Staff believes that assessed land values for the current 2000-2001 tax year are the best indicators of market value and should be used to estimate fast land values for the subject sites.

Considering the significant discount for submerged land (50%), a small overstatement in assessed land value which may have occurred in some instances due to miscellaneous improvements inadvertently being included under land rather than building assessed value was considered insignificant.

Method 2: The per sq. ft. value of the abutting residential fast land is estimated assuming an enhancement of land value due to the presence of a pier. The per sq. ft. value of the submerged land is calculated as a percentage of the enhanced per sq. ft. value of the abutting residential fast land. A residential rate of return is applied to the value of the submerged land to determine the annual rent. A present value factor is applied to the rent or an appropriate percentage is applied to the value of the submerged land to determine the lump sum payment.

$(\text{enhanced fast land } \{sf\} \times 50\%) \times \text{pier footprint} \times 0.8843 = \text{lump sum pmt.}$

Method 3: The per sq. ft. value of the abutting residential fast land is not used. Instead, the per sq. ft. value of the submerged land is calculated as a percentage of the per sq. ft. value of conservation land. A conservation rate of return is applied to the value of the submerged land to determine the annual rent. A present value factor is applied to the rent or an appropriate percentage is applied to the value of the submerged land to determine the lump sum payment.

$(\text{conservation land } \{sf\} \times \text{percent}) \times \text{pier footprint} \times 0.8843 = \text{lump sum pmt.}$

Method 4: The rent is based on mooring fees for recreational boats in small boat harbors on Oahu as specified in the Administrative Rules. A present value factor is applied to the rent to determine the lump sum payment.

$\text{mooring fee per linear ft.} \times \text{pier length} = \text{monthly rent} \times 12 = \text{Annual rent}$
 $\text{annual rent} \times 22.1086 \text{ PV factor} = \text{lump sum payment}$

Analysis:

Method 1: This is the most commonly used method. It is used by the Department of Transportation, Harbors Division when leasing submerged lands for commercial purposes and by the Division of Boating and Ocean Recreation [DOBOR] when leasing submerged lands for commercial and recreational boating activities. Examples include:

Facility	Lessee	Submerged Land
Honolulu Pier 5	Webe Corp.	40% of fast land
Honolulu Pier 6	Navatek	50% of fast land
Nawiliwili Harbor	-	50% of fast land
Nawiliwili Harbor	Gent-Lee	36.5% of fast land *
Port Allen Harbor	Dept. of Navy	40% of fast land
Keehi Lagoon	Keehi Marine Center	50% of fast land
Keehi Lagoon	La Mariana Sailing Club	50% of fast land

* Revocable Permit

When applied to the Kaneohe Bay properties, it assumes the highest and best use of the residential fast land is a residential site with a pier. In so doing, it considers the pier and fast land to be a single residential unit. It begins with an estimate of the fast land without the added value of a pier. The submerged land value is then calculated and a residential rate of return applied because the submerged land is part of a single residential unit. This is the most accurate method because the value of the submerged land is tied to the value of the land it supports.

Method 2: This method was used for a time by DLNR to determine submerged land rent for revocable permits. This method is identical to Method I except the value of the fast land is enhanced due to the added value of the pier. In the past, sites with piers were said to have an enhanced value of 10 percent. The following example illustrates Method 2:

Land value (no pier):	\$200,000
Land area (sf):	5,000
Per sq. ft. value	\$40
Enhanced value (10%)	\$44
Submerged land value (50%)	\$22
Submerged land area (sf):	400
Submerged land value	\$8,800
Rate of return	4%
Annual rent	\$352
Monthly rent:	\$29.33
Monthly tenancy discount (25%)	\$7.33
Monthly rent:	\$22.00

Using the above worksheet, it would seem the pier contributes \$20,000 of value to the fast land ($220,000 - 200,000$). A more correct approach would be to compare sites with piers to sites without piers and utilize a residential rate of return to arrive at an annual rent ($\$220,000 - \$200,000 = \$20,000 \times 0.04 = \800). The difficulty lies in supporting the pier adjustment (currently 10%) with limited market data which itself requires substantial adjustment. Because of this, Method 2 is not considered a viable alternative.

- Method 3:** This method is similar to Method 1 except the value of the submerged land is calculated based on the value of conservation land. Additionally, a conservation rate of return is used to determine the annual rent. As a stand alone conservation zoned parcel, the **submerged land essentially has no value**. This method is inappropriate for the Kaneohe Bay parcels because the pier is not a stand alone parcel. The fast and submerged land are viewed as a single residential unit. As such, this methodology is not considered a viable alternative.
- Method 4:** This method would apply the monthly per linear foot mooring fee as specified in the Administrative Rules to the pier length to arrive at monthly rent. An annual rent could then be calculated. Currently the Administrative Rules indicate a rent of \$2.80 per linear foot per month. This assumes one boat per pier and no added services such as utilities. It also assumes the pier is owned by the State or that the owner has had sufficient time (usually 10 years) to amortize the cost to construct. Under this method a 10 foot pier would require an annual rent of \$336 and a 30 foot pier would require an annual rent of \$1,008. These rates are based on marina facilities owned and operated by the State. This methodology is inappropriate for private, non-commercial residential piers, and as such is not considered a viable alternative.

Follow-up discussion with Pier Owners Group:

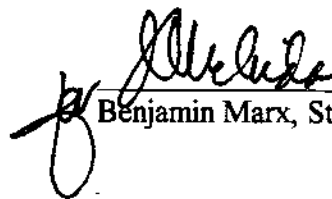
Staff had a meeting with several members of the pier owners group who were interested in the lease rent issue. The meeting was held on Tuesday, February 13, 2001 at 6:30 pm in the Land Division Conference room. The methodology was explained to the group, and a sample was calculated based on an assumed land valuation and pier area. The group discussion involved proposals for: 1) a flat valuation for the submerged lands not tied to the adjacent fast lands; 2) a rate structure based on the area of the pier; and 3) alternatives to the 50% discount used. After the discussion, the group indicated that they would be taking this matter to the pier owners at a meeting scheduled for Friday, February 16, 2001. We asked that they inform us as to the outcome of their meeting, as we were scheduling this for the February 23, 2001 Board meeting. We anticipate that members of the group will be present at the Board meeting.

It is staff's belief that "Methodology 1" provides a fair and accurate value for the leasing of private, non-commercial residential piers. It accurately reflects the use of the submerged lands in conjunction with the adjacent residential fast lands. As such, staff recommends as follows:

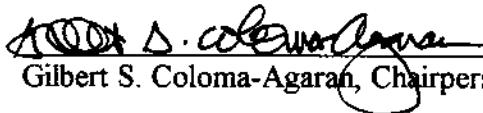
RECOMMENDATION:

That the Board of Land and Natural Resources adopt alternative **Methodology 1** **together with 2000-2001 assessed values** to determine appropriate lease rental rates for private non-commercial residential piers on Kaneohe Bay, Oahu.

Respectfully submitted,


Benjamin Marx, Staff Appraiser

Approved for Submittal:


Gilbert S. Coloma-Agaran, Chairperson

[As amended by the Board of Land and Natural Resources]

D7. **Approved as Amended.**—The Board amended the staff recommendation to include the following:

- A.** That the Board of Land and Natural Resources adopt alternative **Methodology 1 together with 2000-2001 assessed values** to determine appropriate lease rental rates for private non-commercial residential piers on Kaneohe Bay, Oahu.
- B.** *That the Board require staff to review the possible imposition of fines for those piers presently in violation of the law.*
- C.** *That the Board require the staff to provide quarterly progress reports on the issuance of private non-commercial recreational piers at Kaneohe Bay.*